

**MINUTES OF THE APPRAISAL COMMITTEE
for the Conversion of
Blue Cross & Blue Shield United of Wisconsin**

February 14, 2000
Conference Rm. 6 of the Lake Terrace State Office Building
121 East Wilson Street
Madison, Wisconsin

Committee members present: Randy Blumer, Mark Femal, and Patricia Lipton

OCI staff members present: Guenther Ruch, Eileen Mallow, Fred Nepple, Julie Walsh, and Steven J. Junior

Representatives of Deutsche Banc Alex. Brown: Thomas W. Johnson (by telephone from Baltimore) and Giles E. Harrison (by telephone from New York City)

Representatives of Donaldson, Lufkin, & Jenrette (Investment Bankers for Blue Cross & Blue Shield United of Wisconsin): David Platter and Ben Adams (by telephone from New York City)

Other members of the public present: Stephen E. Bablitch, Joseph C. Branch, Gary Fisher, L. Jane Hamblen, Gail L. Hanson, Thomas Luljack, William Tolman, Wade M. Williams, and Jeanne Wittig

Each public attendee who arrived either before or within a few minutes after 4:00 p.m., the scheduled commencement time, received an agenda for the meeting.

Each Appraisal Committee member and OCI staff member, received a packet of documents, including the following items:

1. Agenda for the meeting.
2. A copy of the appraisal committee report as approved at the last meeting.
3. A redlined version of the appraisal committee report as approved at the last meeting, indicating the changes that were approved during the last meeting.
4. A redlined version of the appraisal committee report, with a change proposed (and ultimately adopted) concerning United Heartland Group, Inc. ("UHG") board composition.

The following documents were distributed after the meeting to public attendees requesting them:

1. A copy of the appraisal committee report as approved at the last meeting.
2. A copy of the appraisal committee report, with a change proposed (and ultimately adopted) concerning UHG board composition, and note of an amendment made to recommendation #6.

The Appraisal Committee meeting commenced at 4:15 p.m.

Mr. Femal, the committee's chairman, opened with a discussion of the minutes of the January 27, 2000, and February 9 – 10, 2000 committee meetings. All members of the committee wanted additional time to review the minutes of these meetings. In addition, it was noted that Deutsche Banc representatives had suggestions for changes to the draft version's wording. Mr. Ruch requested the committee's consent to post the draft minutes to the OCI website until the committee approved final versions. Mr. Femal and Mr. Blumer expressed their preference that OCI wait for the final, approved minutes to prevent any confusion. Ms. Lipton said that, after today she would not be available to perform any Appraisal Committee functions, but had no

problem allowing Mr. Femal and Mr. Blumer to decide upon the final form of the minutes. Mr. Blumer suggested that Deutsche Banc discuss their suggested changes with OCI staff. OCI staff would distribute revised minutes of the January 27, 2000, and February 9 – 10, 2000 meetings for the committee's review, and, if there were no objections from a quorum of the committee members, the minutes would be posted to OCI's website. Mr. Blumer moved to adopt the suggested course of action, which was then seconded by Ms. Lipton and carried unanimously.

Mr. Femal introduced two matters for the committee's consideration. First, the committee would revisit the question of what minimum proportion of the UHG board should be "Independent" (as defined by the BlueCross BlueShield Association or "BCBSA") as compared to nominated and elected by the public shareholders. Second, the committee would discuss the minimum public equity offering size and minimum public equity float that should be required in conjunction with the conversion.

Mr. Ruch briefly described the three alternatives relating to the composition of UHG's board of directors that were presented for the committee's consideration at the last meeting. Each of the alternatives concerned the minimum percentage of "Independent" directors that should compose the UHG board. The first option would retain the 80% minimum proposed in Blue Cross' Application for Conversion. The second option would reduce the minimum percentage of "Independent" directors from 80% of the board to 50% of the board, based on the percentage of public market investors' ownership of UHG stock, and a mechanism acceptable to the Commissioner would be created to allow for the nomination and election by the public market investors of truly independent directors. The third option would have immediately reduced the minimum percentage of "Independent" directors to 50%, and a mechanism approved by the Commissioner would be created to allow for the immediate nomination and election of truly independent directors. At the last meeting, the committee resolved to recommend that the 80% minimum be retained, but that there be a mechanism for the nomination and election of 20% of the board by the shareholders.

Mr. Blumer proposed that the committee recommend a gradual reduction of the minimum percentage of "Independent" directors from 80% to 50% of the board in a manner approved by the Commissioner so that the percentage of truly independent directors increases with the percentage of public market investors' ownership of UHG stock, with the further requirement that there be a mechanism developed to actively encourage and allow for the nomination and election of directors by these shareholders.

Mr. Femal stated that Mr. Blumer's proposal was consistent with the committee's desire to enhance the valuation of UHG stock for the benefit of the Foundation. The concern he had at the last meeting with any recommendation that allowed less than 80% of the board to be "Independent" was that BCBSA might find it unacceptable.

Mr. Johnson commented that, based on the meeting with BCBSA, the option of immediately reducing the minimum percentage of "Independent" directors to 50%, and requiring a mechanism for the nomination and election of "non-Independents" would be, in all likelihood, be acceptable to BCBSA, although it would depend upon BCBSA's comfort with the entire "package" of governance provisions brought to it for approval. A plan to gradually phase in the election of non-Independent UHG directors nominated by the shareholders other than the Foundation, to a level less than a majority of the UHG Board, might be acceptable to BCBSA if the phase in was based on the reduction of shares held by the Foundation. Such a phased-in election of directors may be perceived by shareholders as enhancing the value of the UHG stock. Directors elected by the shareholders might ensure that strategic issues that come before the board receive a fair hearing and thorough review, from the perspective of the shareholders. Based on the meeting with Mark

Orloff, Deputy Counsel of the BCBSA, Mr. Johnson believed that Mr. Blumer's proposal would be acceptable to the BCBSA if properly structured.

Mr. Ruch noted the presence of OCI staff, including himself, at the BCBSA meeting, and confirmed Mr. Johnson's impression of the feasibility of Mr. Blumer's proposal. Mr. Ruch added that OCI staff had discussions with BCBSUW management, who did not feel a gradual increase in the number of non-Independent directors elected by shareholders would be problematic with the BCBSA.

Mr. Harrison stressed that merely changing UHG's articles of incorporation to permit the higher proportion of shareholder nominated directors would not, in itself, guarantee the nomination or election of such directors. There must be a specific mechanism to increase the probability of that result.

Mr. Femal stated that Mr. Blumer's proposal would appear to offer the possibility of enhancing the valuation of UHG stock, but asserted that OCI's involvement should only extend to review and approval of the mechanism for shareholder nomination and election of directors. Mr. Femal asked whether the intention of the proposal was to involve the Commissioner in the nomination and election process itself. Mr. Ruch responded that the Commissioner would not be involved in any election of UHG directors, but only in the review and approval of the mechanism.

Mr. Blumer moved that the committee adopt his proposal. The motion was seconded by Ms. Lipton, and carried unanimously.

Mr. Femal introduced the topic of the minimum float and minimum initial public offering or follow-on offering, and recognized Mr. Ruch for the purpose of providing all attendees with a description of the Appraisal Committee's recommendation on this subject.

Mr. Ruch explained that the appraisal committee report sets two separate and distinct standards, one for a minimum post-conversion float and the other for a minimum public offering size. The committee's recommendation was that the BCBSUW conversion should not be permitted unless UHG, or its successor, can achieve a minimum post-conversion float of \$75 million through a merger with United Wisconsin Services, Inc., a public equity offering, or both. Under the committee's recommendation, UHG could apply to the Commissioner for consent to an IPO smaller than \$75MM which would result in a smaller initial post-conversion float, but the committee advises that in no instance should the Commissioner consent to an IPO and thereby initial float of less than \$50 million. The committee further recommended that the BCBSUW conversion should not be permitted unless UHG, or its successor, can complete an initial public offering or follow-on offering of \$75 million. Once again, under the committee's recommendation, UHG could apply to the Commissioner for consent to a smaller minimum equity offering, but the committee advises that in no instance should the Commissioner consent to an equity offering of less than \$50 million.

Mr. Femal confirmed his agreement with the present wording of the recommendation, but he acknowledged his reliance upon Ms. Lipton and Deutsche Banc for the specific thresholds that had been selected. Ms. Lipton confirmed her agreement with the present language. Mr. Blumer affirmed his support of the current language, with reliance on advice provided by Deutsche Banc for the specific thresholds that had been selected.

Mr. Johnson explained that the size of the equity offering should be material enough to interest institutions, and the resulting float should provide adequate liquidity to maintain an aftermarket that permits the Foundation to effectuate orderly future sales of its shares.

Mr. Femal introduced a letter to the members of the appraisal committee from Joseph C. Branch, counsel for BCBSUW, expressing concern, among other matters, that UHG might not be able to meet the thresholds the committee is recommending. Mr. Femal indicated that he had once again reviewed the information in the conversion resource book provided by Deutsche Banc related to the size of other initial public offerings in the health insurance and managed care sector, with the conclusion that the committee's recommended thresholds do not appear out-of-line.

Mr. Johnson remarked that, if UHG cannot raise \$50 million, one should question whether UHG should complete an offering at all. When Deutsche Banc reviewed the field of non-Internet IPOs completed in 1999, the firm noted that over 60% of the IPOs were larger than \$50 million. In some instances, successful public equity offerings are conducted for less than \$50 million; however, these smaller offerings are often sold with the expectation that aggressive growth in the company's business will likely increase float significantly through price appreciation. Mr. Johnson did not foresee Blue Cross achieving a 20% growth in revenue, so it was difficult for him to see how earnings could grow at a high enough rate to expect significant stock price increases.

Mr. Blumer noted that the committee is recommending that the Commissioner permit BCBSUW to select for conversion any date for conversion within six-months of the Commissioner's decision or related order, with the possibility of an extension for an additional six months depending upon the facts and circumstances. The intention of the committee is to have the first monetization event for the Foundation establish a definitive base of valuation, with sufficient liquidity to facilitate orderly future sales of shares by the Foundation. Ms. Lipton moved to confirm the committee's position with respect to the minimum post-conversion float and the minimum public equity offering size.

Mr. Femal again introduced Mr. Branch's letter in order to address the concern raised about the committee's recommendation that the Commissioner impose a temporary prohibition on the issuance of equity options to directors, officers, and employees as a condition to her approval of the conversion plan. Mr. Femal described his satisfaction with the approach the committee adopted at the last meeting, but solicited comments from the Deutsche Banc representatives and the other committee members.

Mr. Johnson said that he had nothing new to add since the last meeting. Mr. Harrison noted that the committee had decided that it was appropriate to add a carve-out to recommendation #6 for a director of UWS who is scheduled to be seated in May 2000, and asked whether the committee would want to consider a carve-out for new officers.

Mr. Johnson rejoined that he had no information at hand on precedents for new officers receiving options during a reasonable time frame preceding and following a conversion or demutualization. He urged the committee to consider the appearance of propriety of any such grants.

Ms. Lipton inquired whether OCI or Deutsche Bank expected a major restructuring of management and whether BCBSUW had been given an opportunity to discuss upcoming changes in the management team.

Mr. Ruch asked Deutsche Banc if that question had been considered during the course of their due diligence review. Mr. Johnson recalled that there had been some new officers hired around year-end 1999.

Mr. Nepple stated his understanding that the existing wording in the last sentence of recommendation #6 recommends that the Commissioner review the options grants in January 2000, but was not intended to suggest that the Commissioner reserve authority to modify the

moratorium on new options grants. He stated that his recollection was that the Committee intended that the moratorium should be absolute from the date of the committee's report until one year following the date UHG becomes a publicly traded corporation.

Mr. Femal and Ms. Lipton indicated that it had been their understanding that the wording of recommendation #6 advised the Commissioner to review any options grants going forward within the limited time frame recommended. Mr. Blumer noted that he had understood the recommendation prohibited option grants going forward and that the Committee had not intended to recommend that the Commissioner reserve authority to modify that restriction.

Mr. Johnson and Mr. Harrison provided the committee with information on the overall level of options granted in relation to shares issued and outstanding. Mr. Johnson concluded that UWS does not have the lowest ratio of options outstanding to shares issued and outstanding, but that the level of options outstanding appears to be within the range of what is reasonable.

Mr. Blumer raised the possibility that the committee should perhaps consider recommending allowing new options during the moratorium, but only with respect to new officers hired during the moratorium. Mr. Nepple offered the possibility that the committee could recommend that such options awards require the Commissioner's review and approval. Ms. Lipton expressed the view that this would be an appropriate means to address unforeseen circumstances, while retaining the moratorium.

Mr. Blumer proposed that recommendation #6 be amended to allow a new director or officer, hired during the moratorium to receive options subject to the Commissioner's approval. Ms. Lipton moved that the proposal be adopted. Mr. Blumer seconded the motion, and it carried unanimously.

Mr. Blumer asked Ms. Walsh to read the specific language she would propose to effectuate the committee's decision. Ms. Walsh read the following sentence aloud: "If, however, a new director or officer of UHG, BCBSUW or UWS (or any affiliate of these entities) should be hired during this interim period, equity options may be granted subject to the approval of the Commissioner." Ms. Walsh also read the last sentence of recommendation #6, which was amended to insert the word "existing" to clarify that that sentence related solely to the options granted in January 2000. All of the committee members agreed that the language accomplished their intent.

At their request, the committee members were presented the signature page of their final and adopted report. Mr. Femal, as chairman signed first, followed by Ms. Lipton, and then Mr. Blumer.

Mr. Femal inquired as to the future course of the appraisal committee report.

Mr. Ruch explained that bound, color copies of Exhibit 1 would be received from Deutsche Banc via Federal Express tomorrow. The report would be served upon BCBSUW as the applicant for conversion. BCBSUW would have ten days to comment on the report. The appraisal committee report and any rebuttal from BCBSUW would be entered into the record of hearing that the Commissioner would use as a basis for her decision on the proposed conversion.

Mr. Nepple noted for the committee's information that there will be an early March hearing event intended to allow groups that had unsuccessfully attempted to intervene as parties with standing in the proceeding to offer information for the hearing record.

The committee adjourned at 5:14 p.m.